

CALIFORNIA DEPARTMENT OF INSURANCE
LEGAL DIVISION
Compliance Bureau - San Francisco
Brian D. FitzGerald, Bar No. 118255
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: 415-538-4104
Facsimile: 415-904-5490

Attorney for The California Department of Insurance

**BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA**

In the Matter of the Rates, Rating Plans, or
Rating Systems of

MERCURY INSURANCE GROUP

(MERCURY CASUALTY
COMPANY, MERCURY
INSURANCE COMPANY,
CALIFORNIA AUTOMOBILE
INSURANCE COMPANY,
AMERICAN MERCURY
INSURANCE COMPANY and
CALIFORNIA GENERAL
UNDERWRITERS INSURANCE
COMPANY, INC.),

Respondents.

NOTICE OF NONCOMPLIANCE

File No. NC-04-038852

TO: MERCURY CASUALTY COMPANY, MERCURY INSURANCE COMPANY,
CALIFORNIA AUTOMOBILE INSURANCE COMPANY, AMERICAN MERCURY
INSURANCE COMPANY and CALIFORNIA GENERAL UNDERWRITERS INSURANCE
COMPANY, INC. AND TO THEIR ATTORNEY(S) OF RECORD:

YOU ARE HEREBY NOTIFIED that the Insurance Commissioner of the State of
California ("the Commissioner") has good cause to believe that the rating and underwriting
practices of Mercury Casualty Company (MCC), Mercury Insurance Company (MIC), California
Automobile Insurance Company (CAIC), American Mercury Insurance Company (AMIC) and
California General Underwrites Insurance Company, Inc. (CGUIC) (collectively, "the

1 Respondents” or the “Mercury Group”), are in violation of various provisions of California law
2 including, but not limited to, California Insurance Code sections 491, 677.2(c), 790.02, 790.06,
3 1857, 1861.02(b)(1), 1861.02(c), 1861.025, 1861.03(a), 1861.03(c)(1), 1861.05(a), 1861.16(b),
4 11580.08, and California Code of Regulations (“CCR”), Title 10, Chapter 5 , Subchapter 4.7,
5 sections 2360.0(b), 2360.2, 2360.3, 2360.4, 2404, 2430, 2431, 2470, 2632.5(c)(1)(A),
6 2632.5(d)(11), 2632.12(b), 2632.13, 2632.13 (c), 2632.14(b), 2632.19. The nature and extent of
7 the Respondents’ noncompliance is set forth below. The California Department of Insurance
8 (“the Department”) is informed and believes, and thereon alleges, the following:

9 1. The Respondents currently are, and at all times relevant hereto were, insurers
10 licensed to transact various classes of insurance in California including, but not limited to, those
11 classes of insurance discussed below.

12 2. On or about March 16, 2004, following a field examination of the Respondents,
13 the Commissioner issued a Report of Examination of the Rating and Underwriting Practices of
14 the Mercury Insurance Group of Companies (“the Report”). The Report covered the period of
15 January 1, 2001 to August 31, 2002. The Report documents that all of the violations, which are
16 set forth below as instances of non-compliance, were underwriting practices of the Respondents
17 on August 31, 2002. At or about the time the Report was issued, the Commissioner informed the
18 Respondents that their underwriting practices, as set forth below, were in non-compliance with
19 California law. At the same time, the Commissioner told the Respondents to bring their
20 underwriting practices into compliance with California law.

21 **FIRST NONCOMPLIANCE**

22 (Telephone inspection requirements)

23
24 3. Mercury Casualty Company, Mercury Insurance Company and California
25 Automobile Insurance Company use failure to obtain telephone inspections as a reason for
26 cancellation or non-renewal. These Respondents required telephone inspections to be conducted
27 to verify information already provided on the personal auto insurance application. If a telephone
28 inspection was unable to be obtained for a risk, then the Respondents non-renewed the policy.

1 The failure to obtain a telephone inspection report does not represent a substantial increase in
2 hazard nor does it have a substantial relationship to the risk of loss. The Respondents have not
3 agreed to change this unauthorized rating factor or to re-offer coverage to those non-renewed due
4 to this practice. This is a violation of Sections 1861.03(c)(1) and 1861.05(a) of the California
5 Insurance Code and California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Sections
6 2360.0(b), 2360.2 and 2632.19.

7 **SECOND NONCOMPLIANCE**

8 (Failure to disclose coverage differences)

9 4. Mercury Casualty Company, Mercury Insurance Company and California
10 Automobile Insurance Company fail to disclose coverage and premium differences and do not
11 offer the consumer a choice between the three companies offering Private Passenger Automobile
12 (“PPA”) coverage. These Respondents fail to allow California Good Drivers the opportunity to
13 select coverage from each of the three personal auto programs offered. The Respondents do not
14 allow equal access to all of its personal auto programs to their appointed agents and independent
15 brokers. In addition, those producers who do have access to all three programs do not
16 consistently disclose coverage and premium differences to Good Drivers seeking insurance
17 coverage. This is a violation of Sections 1861.02(b)(1), 1861.05(a) and 1861.16(b) of the
18 California Insurance Code and California Code of Regulations, Title 10, Chapter 5, Subchapter 3,
19 Sections 2360.3, 2360.4 and 2632.14(b).

20 **THIRD NONCOMPLIANCE**

21 (Lack of objective eligibility guidelines)

22 6. Mercury Casualty Company, Mercury Insurance Company and California
23 Automobile Insurance Company, which offer Personal Passenger Automobile (“PPA”) coverage,
24 do not have objective guidelines for non-good drivers with six or more driver safety record
25 points. These Respondents’ underwriting guidelines for *non-good* drivers, that is, drivers who do
26 **not** qualify as California Good Drivers under the provisions of California Insurance Code section
27 1861.025, allow subjectivity in eligibility determination for drivers with six or more driver safety
28 record points. As the Respondents lack definitive eligibility criteria, non-renewal decisions are

1 made based upon subjective evaluation of the driver's safety record and do not meet the
2 requirements of the substantial increase in hazards provisions for the non-renewal of auto
3 insurance policies. The Respondents have not established and implemented guidelines for non-
4 good drivers which satisfy the requirements to be specific, objective, and substantially related to
5 an insured's loss exposure. This is a violation of Sections 1861.03(c)(1) and 1861.05(a) of the
6 California Insurance Code and California Code of Regulations, Title 10, Chapter 5, Subchapter 3,
7 Sections 2360.0(b), 2360.2 and 2632.19.

8 **FOURTH NONCOMPLIANCE**

9 (Use of violation dates in underwriting)

10 7. Mercury Casualty Company, Mercury Insurance Company and California
11 Automobile Insurance Company use violations without conviction dates in termination practices.
12 These Respondents will use a violation without a conviction appearing on an insured's Motor
13 Vehicle Record ("MVR") to non-renew policies. The use of violations without convictions does
14 not meet the criteria prescribed by the substantial increase in hazard regulations as a legitimate
15 basis for non-renewal. The Respondents have not agreed to revise this procedure or to re-offer
16 coverage to insureds non-renewed due to this practice. This is a violation of California Insurance
17 Code sections 1861.03(c)(1) and 11580.08 and California Code of Regulations, Title 10, Chapter
18 5, Subchapter 4.7, Sections 2632.5(c)(1)(A), 2632.13 and 2632.19.

19 **FIFTH NONCOMPLIANCE**

20 (CAARP cancellations)

21 8. California Automobile Insurance Company cancels assigned risk policies if the
22 insured fails to return or sign named driver exclusions. The 2002 examination uncovered
23 correspondence between this Respondent and its assigned risk insureds which indicated that the
24 Respondent intended to cancel policies due to the lack of a signed named insured driver exclusion
25 or for failure to complete telephone questionnaires. Current California Automobile Assigned
26 Risk Plan ("CAARP") laws prevent cancellation of a policy due to the failure to provide
27 information which would not make the insured ineligible under the plan. This is not in
28 compliance with the California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Sections

1 2404, 2430, 2431 and 2470 (Repealer August 25, 2004; now the CAARP Manual)

2 **SIXTH NONCOMPLIANCE**

3 (“PPA” tie-in requirements for eligibility)

4 9. Mercury Casualty Company continues to require a supporting auto policy in order
5 to purchase a homeowner’s policy. This Respondent informed the Department that it had ceased
6 this practice on August 29, 2002. However, in a December 2003 policy review, it was confirmed
7 by the Department’s attempt to obtain quotes for stand-alone homeowner’s coverage that this
8 Respondent continues to require that an applicant for a homeowner’s policy must have a
9 supporting auto policy in order to be eligible for coverage, contrary to its previous indication.
10 The policy review, along with recent attempts made by Departmental staff to obtain a
11 homeowners-only quote, revealed that the Respondent is still requiring a supporting auto policy.
12 This is a violation of Sections 790.02, 790.06, 1861.02(b)(1), 1861.03(a), 1861.05(a) of the
13 California Insurance Code and California Code of Regulations, Title 10, Chapter 5, Subchapter 3,
14 Sections 2360.0(b) and 2360.2.

15 **SEVENTH NONCOMPLIANCE**

16 (Capping of premium credits)

17 10. Mercury Casualty Company places a cap on the premium credit available to
18 combined discounts. This Respondent’s commercial auto rating plan limits the percentage of
19 credit available for deductibles and discounts to which insureds are entitled. The commercial
20 auto plan allows a maximum of 25% credit total for the four discounts offered under the plan.
21 The maximum credit available from the four discounts combined is 45% without the credit
22 limitation. The imposition of a maximum credit is unfairly discriminatory as some insureds will
23 not receive the full premium benefit of the credit and it also allows for the application of
24 excessive rates. This is a violation of California Insurance Code section 1861.05(a).

25 **EIGHTH NONCOMPLIANCE**

26 (Non-compliant persistency rule)

27 11. The persistency rule of the respondents Mercury Casualty Company, Mercury
28 Insurance Company and California Automobile Insurance Company uses an insured risk’s loss

1 experience and the number of years the insured has been continuously insured with no lapse in
2 coverage in excess of 30 days to determine eligibility for the credit. Continued use of a
3 persistency discount that utilizes prior insurance with unaffiliated carriers, and combines driving
4 safety record with length of persistency to determine eligibility for the discount is non-compliant
5 with the provisions of the persistency regulation currently applicable to Respondents. This is a
6 violation of California Insurance Code sections 491 and 1861.02(c) and California Code of
7 Regulations, Title 10, Chapter 5, Subchapter 4.7, Sections 2632.5(c)(1)(A), 2632.5(d)(11) and
8 2632.13(c).

9 **NINTH NONCOMPLIANCE**

10 (Named driver exclusions)

11 12. Mercury Casualty Company, Mercury Insurance Company and California
12 Automobile Insurance Company were not properly offering Good Drivers coverage, excluding
13 ineligible non-good drivers in the event of a non-renewal or cancellation. In the cancellation and
14 non-renewal process, the Respondents were sending a notice to the producers letting them know
15 that the Good Driver could be covered if the ineligible non-good driver were excluded. There
16 was no procedure in place to ensure that this offer was communicated to the consumer and to
17 document the offer to the consumer. Since this is repetition of what was an issue in the prior
18 1998 examination and report, there was inconsistency in the offering of PPA coverage to Good
19 Drivers, excluding ineligible non-good drivers, a violation of Sections 1857, 1861.02(b)(1), and
20 1861.025 of the California Insurance Code and California Code of Regulations, Title 10, Chapter
21 5, Subchapter 4.7, Section 2632.12(b).

22 **TENTH NONCOMPLIANCE**

23 (Use of "C-codes")

24 13. Mercury Casualty Company was unfairly preventing insureds from making
25 changes to their policy coverages and from re-applying for coverage due to past non-renewals.
26 Mercury's administrative process known as "C-Coding" unfairly prevents consumers from being
27 able to make coverage changes to their policies and prevents otherwise eligible risks from being
28 able to retain or apply for coverage. C-coded policies were not allowed to make mid-term

1 changes to coverage or limits. The C-code remained in the system for three years, even if the
2 insured corrected the problem and regained eligibility, meaning no coverage changes were
3 allowed. The use of "C-codes" on homeowner's policies, to designate risks who were non-
4 renewed due to failure to meet guidelines, is a violation of California Insurance Code sections
5 790.02, 790.06 and 1861.05(a). In a repeat criticism from the prior 1998 examination and report,
6 those who were non-renewed and returned to Mercury at a later date meeting all new business
7 criteria were not allowed to purchase a policy until the C-code expired. Although the Respondent
8 agreed to change its system, the repetitiveness and gravity of this issue necessitate the citation of
9 this violation.

10 **ELEVENTH NONCOMPLIANCE**

11 (Failure to give 30 days cancellation notice)

12 14. Mercury Casualty Company did not consistently provide 30 days advance notice
13 of cancellation for commercial auto insureds, as required by California Insurance Code section
14 677.2(c).

15 **NONCOMPLIANCE PENALTIES**

16 1. RESPONDENTS ARE HEREBY NOTIFIED that all noncompliances referred to
17 herein must be corrected within ten (10) days of receipt of this Notice and proof of such
18 correction, or other response permitted by California Insurance Code section 1858.1, must be
19 presented to the Commissioner by that time.

20 2. RESPONDENTS ARE FURTHER NOTIFIED that if they fail to make an
21 adequate or timely response, the Commissioner will set a public hearing pursuant to California
22 Insurance Code sections 1858.2 and 1858.3. If, at the conclusion of such hearing, the
23 Commissioner finds that the facts are as set forth above and that such facts constitute violations of
24 the applicable sections of the California Insurance Code and the California Code of Regulations,
25 as set forth above, he may issue an order for the payment of money penalties and such other
26 corrective action as he may deem appropriate.

27 3. RESPONDENTS ARE FURTHER NOTIFIED that the Commissioner is informed
28 and believes that the Respondents have engaged in at least one willful act involving the use of

1 rates, rating plans, and/or rating systems in violation of Chapter 9, Part 2, Division 1 of the
2 California Insurance Code. Pursuant to California Insurance Code sections 1858.07 and 1858.3,
3 the Commissioner shall determine the total number of willful acts committed by the Respondents
4 and shall impose the penalty imposed by section 1858.07. The Commissioner reserves the right
5 to amend this Notice to set forth additional willful acts in violation of Chapter 9, Part 2, Division
6 1 of the California Insurance Code and the Commissioner reserves the right to seek additional
7 penalties therefore in the amount of \$10,000.00 for each such act.

8 4. RESPONDENTS ARE FURTHER NOTIFIED that, alternatively, in the event that
9 the aforesaid acts involving the use of rates, rating plans, and/or rating systems in violation of
10 Chapter 9, Part 2, Division 1 of the California Insurance Code are not found to be willful
11 violations of said Chapter, then pursuant to Insurance Code Section 1858.07, the Commissioner
12 will seek the imposition of civil penalties in the amount of \$5,000.00. The Commissioner
13 reserves the right to amend this Notice to set forth additional acts in violation of Chapter 9, Part 2,
14 Division 1 of the California Insurance Code and the Commissioner reserves the right to seek
15 additional penalties therefore in the amount of \$5,000.00 for each such act. The Commissioner
16 further reserves the right to seek any other penalties provided for under California Insurance Code
17 section 1858.07 in the event that the act set forth above, or such acts as may be alleged upon
18 amendment hereof, were inadvertent.

19
20 Dated: November 16, 2005.

CALIFORNIA DEPARTMENT OF INSURANCE

21
22 By _____/s/
23 Brian D. FitzGerald
24 Senior Staff Counsel
25
26
27
28